VZCZCXYZ0000
PP RUEHWEB

DE RUEHQT #2672/01 3551859
ZNR UUUUU ZZH
P 211859Z DEC 07
FM AMEMBASSY QUITO
TO RUEHC/SECSTATE WASHDC PRIORITY 8222
INFO RUEHBO/AMEMBASSY BOGOTA 7201
RUEHCV/AMEMBASSY CARACAS 2806
RUEHLP/AMEMBASSY LA PAZ DEC LIMA 2237
RUEHGL/AMCONSUL GUAYAQUIL 3159

UNCLAS QUITO 002672

SIPDIS

SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: EFIN ECON PGOV EC
SUBJECT: Public and Private Sectors Discuss Possible Banking Reforms

Ref. Quito 1655

¶1. (SBU) Summary. GOE representatives and the banks have agreed on an outline for a second round of banking sector reforms. The banks said that the agreed upon package is reasonable and would not undermine the banking sector, but caution that President Correa or the Constituent Assembly still need to approve the package and might make unacceptable changes. End summary.

¶2. (SBU) In May President Correa sent a draft banking law to Congress, seeking to greatly increase governmental control over the banking sector. Congress significantly walked back the proposal and approved a banking sector reform that imposed some restrictions (eliminated commissions, set maximum interest rates) but that was acceptable to the banking sector (ref a). At the time, Correa stated that he would seek additional changes that he would submit to the Constituent Assembly. In practical terms, real effective interest rates have not changed appreciably since the law was implemented.

¶3. (SBU) In the following months, the private sector has held a series of meetings with GOE officials to discuss possible additional reforms to the banking sector. In several meetings from December 12-14, Central Bank officials and several private sector bankers discussed with Embassy and visiting Treasury officials the basic outcome of the meetings, with all making the same basic points.

Interest rate caps

¶4. (SBU) The two sides agreed to restructure the methodology for calculating maximum interest rates. In the recently approved banking law, maximum interest rates are set by market segment (e.g., housing, commercial, microcredit), based on the market average for the segment, plus a margin. Currently the margin is two standard deviations from average. Bankers believe that over time interest rates will converge toward the average, reducing the standard deviation and therefore the margin. That would bring down the interest rate cap and prevent banks from differentiating products within a market segment.

¶5. (SBU) The GOE and bankers agreed to use a new methodology to set the margin that will establish the maximum interest rate, using averages instead of standard deviations. (For example, if the adjustment factor were 20% and the average interest were 10%, then the maximum interest rate would be 12%.) Initially with banks argued for a large adjustment factor (and therefore a higher cap), while and the government sought a lower factor. One banker said that he expects the final factor to be a compromise between the two positions, probably around 15-20%. The banker explained that the new approach could have benefits for both the government and banks. Initially the new methodology will establish a lower interest cap than the current approach (which the government wants), but over the

medium term it will be more stable (which is what the banks want).

Liquidity Fund

¶6. (SBU) The two sides agreed to establish a liquidity fund to support banks that experience a run on deposits. Currently, since Ecuador is dollarized, there is no lender of last resort, and all banks maintain large reserves (held largely offshore) to shelter themselves from a sudden outflow of deposits. The GOE representatives and bankers agreed that the liquidity fund would be made up of a combination of required reserves (currently held by the Central Bank), bank contributions, and a government contribution. The two sides agreed the funds should be jointly managed, but disagreed on whether the government or the private sector should have control.

New Deposit Insurance Fund

¶7. (SBU) The bankers and the GOE also agreed to establish a new deposit insurance fund, although our interlocutors did not discuss any specifics. Ecuador currently has a deposit guarantee agency, but all of the banks' current contributions are used to compensate depositors who lost their savings in the 1999 banking crisis, so in effect there is no fund to shelter current depositors.

Improve Efficiency

¶8. (SBU) Neither the GOE nor our private sector interlocutors thought that the agreed package would produce a notable drop in interest rates, which is what Correa is looking for. They said that

they also agreed on a modest package of measures that would lower costs (such as ending some mandated fees paid by the banks) and improve efficiency (for example, the liquidity fund might free up more bank resources for lending, and one banker hinted that the GOE might consider a better bankruptcy law that would allow banks to more easily claim loan guarantees).

¶9. (SBU) However, all the people that we talked to thought that these medium-term measures also would not have a dramatic affect on interest rates. One banker said that the key factor in lowering interest rates on loans is more competition. Even before the Correa government took office, foreign banks had not expressed interest in entering the Ecuadorian market, and he asserted that the uncertainty generated by the Correa administration will only increase their reluctance to invest in Ecuador.

Correa to Decide

¶10. (SBU) Our private sector contacts agreed that the discussion that they had with the GOE representatives was professional and technical. They also said that if the package of agreed measures goes forward without major substantive changes, that the new reform package would not create broad risks for the banking sector. However, they stressed that Correa will make the final decision on the to by his representatives, they cautioned that the reforms might create fear among depositors which could affect some institutions. One banker said that one of Correa's biggest fears is a banking crisis, which he said is the banks' "biggest ally" in the reform process.

Constituent Assembly to Approve

¶11. (SBU) The GOE plans to present the banking reform legislation to the Constituent Assembly. The package would probably also include other measures, such as the proposed merger of the Central Bank and Superintendency of Banks. At this time, it is not clear when the GOE plans to submit the package to the Constituent Assembly. However, the private sector bankers also cautioned that, even if the GOE package as approved by Correa is acceptable, there is also a risk that the Constituent Assembly could make unacceptable changes.

Comment

¶12. (SBU) As the bankers have emphasized, there is still uncertainty as to the final shape of the next round of banking sector reforms. However, it is a hopeful sign that the reform process started with discussions between the government and banks (which had not happened before the first law was introduced in May), and that the parties agreed to a reasonable framework, even if they disagreed on several key details.

Jewell